

**ALASKA STUDENT LOAN CORPORATION**  
(a Component Unit of the State of Alaska)

Management's Discussion and Analysis and  
Financial Statements

June 30, 2006 and 2005

Together with Independent Auditors' Report

**Alaska Student Loan Corporation**  
(a Component Unit of the State of Alaska)

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

The Alaska Student Loan Corporation (Corporation) functions as a lender and as a partner with the Alaska Commission on Postsecondary Education in servicing its education loans. The following is a discussion and analysis of the Corporation's financial performance, providing an overview of the activities for the fiscal year ended June 30, 2006. This discussion and analysis contains other supplementary information in addition to the basic financial statements for the year ended June 30, 2006. Please read it in conjunction with the Corporation's financial statements and the notes to financial statements, which follow this section.

**Financial Highlights**

- The Corporation's total assets at June 30, 2006 are approximately \$1 billion, an increase of \$64 million or 6.7% from June 30, 2005.
- The Corporation's long-term debt increased by \$89.8 million during fiscal year 2006, which represents the net difference between new issues and payments of outstanding debt. During the year the Corporation issued bonds in the amount of \$143.3 million.
- The assets of the Corporation exceed its liabilities at the close of the fiscal year by \$171 million (reported as net assets), an increase in net assets of \$2.1 million over June 30, 2005.
- The Corporation's education loans receivable is \$614 million at year-end, an increase of \$23 million during the year.
- The Corporation's operating revenue is \$36.3 million, an increase of \$2.3 million during the year.
- The Corporation's interest expense was \$27.5 million during the year.
- The Corporation's expenses related to operations were \$11.8 million during fiscal year 2006.

**Overview of the Financial Statements**

The Corporation is an enterprise fund of the State of Alaska. As such, the Corporation's financial statements are prepared in conformity with accounting principles generally accepted in the United States as applied on an accrual basis. Under the accrual method of accounting, the same method used by private sector businesses, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred. The three basic financial statements of the Corporation are as follows:

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Balance Sheets - This statement presents information regarding the Corporation's assets, liabilities and net assets. Net assets represent the total amount of assets less the total of liabilities. The Balance Sheets classify assets, liabilities, and net assets as current, non-current, and restricted.

Statement of Revenues, Expenses, and Changes in Net Assets – This statement presents the Corporation's interest income, costs of funds, operating expenses, and changes in net assets for the fiscal year.

Statement of Cash Flows – This statement presents cash flows from operations, non-capital financing, capital, and investing activities. The Corporation presents its cash flows statement using the direct method of reporting operating cash flows.

**Financial Analysis**

The following condensed financial information is derived from the Corporation's financial statements and reflects the Corporation's changes during the fiscal year:

	2006	2005	Percentage Change
Assets:			
Current assets	\$ 51,910,712	42,094,245	23.3%
Restricted assets	967,644,103	913,400,255	5.9%
Total assets	<u>1,019,554,815</u>	<u>955,494,500</u>	<u>6.7%</u>
Liabilities:			
Current liabilities payable			
from unrestricted assets	10,397,655	8,840,497	17.6%
Current liabilities payable			
from restricted assets	168,979,103	198,457,953	(14.9%)
Non-current liabilities payable			
from restricted assets	<u>669,773,654</u>	<u>579,328,180</u>	<u>15.6%</u>
Total liabilities	<u>849,150,412</u>	<u>786,626,630</u>	<u>7.9%</u>
Net assets:			
Restricted net assets	128,891,346	135,614,122	(5.0%)
Unrestricted net assets	<u>41,513,057</u>	<u>33,253,748</u>	<u>24.8%</u>
Total net assets	<u>\$ 170,404,403</u>	<u>168,867,870</u>	<u>1.5%</u>

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

The Corporation's withdrew \$7 million from the Borrower Benefit Account in its 1988 Master Trust Indenture causing an increase in current assets.

Loan originations increased by \$6.1 million, an increase of 9.4% over the prior year.

The Corporation issued the 2005 Education Loan Revenue bonds in the amount of \$58.3 million in July 2005, and the 2006 Education Loan Revenue bonds in the amount of \$85 million in May 2006 to fund education loans.

	2006	2005	Percentage Change
Operating revenue-loan interest income	\$ 36,310,862	33,996,765	6.8%
Operating expenses	(17,792,718)	(16,087,910)	(10.6%)
Non-operating expense, net	(15,081,611)	(12,416,677)	(21.5%)
Income before return of capital	3,436,533	5,492,178	(37.4%)
Return of capital	(1,900,000)	(88,100,000)	97.8%
Change in net assets	1,536,533	(82,607,822)	101.9%
Net assets – beginning	168,867,870	251,475,692	(32.8%)
Net assets – ending	\$ 170,404,403	168,867,870	1.5%

Loan interest income increased as a result of market rate increases.

The Corporation funded \$430,000 of education grants through the AlaskAdvantage® Grant program which was rolled out in fiscal year 2006. This, along with computer related equipment purchases, and increases in personnel benefit and wage costs resulted in an increase in operating expenses.

Interest income from investments, which is reported as a non-operating item, increased \$1.8 million from the previous year as a result of higher market interest rates.

Higher market rates also caused a \$4.7 million increase in bond interest expense.

The return of capital represents payments to the State of Alaska as allowed for by statute. An annual payment as determined by the Corporation's Board of Directors is based on the amount of the Corporation's income before return of capital payment during the fiscal year ending two years before the end of the fiscal year in which the payment is to be made. Additionally, the Corporation issued bonds in fiscal year 2005 to finance projects of the State of Alaska.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Corporation Activities and Conditions Affecting Financial Position

The Alaska Commission on Postsecondary Education (Commission) administers the Corporation's programs under the umbrella title of the AlaskAdvantage<sup>®</sup> Loan Programs. Operating expenditures of the Commission are subject to budgetary appropriation. The Corporation reimburses the Commission for such expenditures that relate to the program administration and are permitted under the bond indentures of the Corporation.

The purpose of the Corporation's programs is to lower costs for Alaskans pursuing education and training at a postsecondary level and for other qualified individuals attending postsecondary institutions in the State.

The AlaskAdvantage<sup>®</sup> Loan Programs include various Federal Family Education Loan Program (FFELP) loans governed by the Higher Education Act and alternative education loans. Loans originated and serviced under the program include fixed and variable interest rate loans.

To accommodate FFELP lending, the Commission has retained status of "eligible lender" under the Higher Education Act and maintains various agreements with Northwest Education Loan Association, to serve as the Commission's "eligible guarantor" under the Higher Education Act. Loans authorized under the Higher Education Act which the Corporation is funding include Subsidized Stafford, Unsubsidized Stafford, and PLUS loans. The Higher Education Act provides for federal (i) insurance or reinsurance of eligible loans, (ii) interest subsidy payment to eligible lenders with respect to certain Subsidized Stafford loans, and (iii) special allowance payments representing an additional subsidy paid by the Secretary of the U.S. Department of Education to holders of eligible loans. For a loan loss to be eligible for reimbursement to a lender by a guarantor the loan must be serviced according to standards set by federal statutes and regulations.

The interest rate on FFELP loans is reset annually each July 1. Subsidized Stafford and unsubsidized Stafford loans which are in in-school, grace, and deferment periods bear interest at a rate equivalent to the 91-day T-bill rate plus 1.7%, with a maximum rate of 8.25%. Subsidized Stafford and unsubsidized Stafford loans in all other periods bear interest at a rate equivalent to the 91-day T-bill rate plus 2.3%, with a maximum rate of 8.25%. PLUS loans bear interest at a rate equivalent to the 91-day T-bill rate plus 3.1%, with a maximum of 9%. Federal consolidation loans bear interest at a rate equal to the weighted average of the interest rates of the loans consolidated, rounded to the nearest higher one-eighth of 1%, with a maximum rate of 8.25. FFELP loans originated after June 30, 2006 will be fixed rate loans. Stafford loans will carry a rate of 6.8%. The PLUS loan rate will be 8.5%

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The interest rate for ASELS originated prior to July 1, 2006 is adjusted annually on or after June 1 and effective for twelve months beginning July 1. According to State statute, the variable interest rates are to be based on the bond equivalent rate of 91-day T-bill auctioned at the final auction held before June 1 of the loan year plus up to 2.8% and are to be capped at 8.25%. For ASELS originated after June 30, 2006, the interest rate is fixed and is based on 1) the Municipal Market Data AAA Insured Alternative Minimum Tax Revenue Bond Yield Curve plus thirty basis points and, 2) the cost of administering the loan programs.

The Corporation also, offers a supplemental consolidation loan to borrowers who have two or more supplemental or Teacher Education Loans under the program.

The AlaskAdvantage<sup>®</sup> Program was structured to provide eligible borrowers with low cost financial aid options. It encourages students to take advantage of federal aid resources to maximize their grant and lowest cost loan options prior to tapping into alternative loan sources.

Between fiscal years 2005 and 2006, the Corporation saw a 9.4% increase in loan originations and continues to have the highest volume of federal loan awards in the state as compared to other federal education loan providers in Alaska. The Corporation's federal loan originations, excluding federal consolidation loans, increased by 10% between fiscal years 2005 and 2006. Federal consolidation loans originated in fiscal year 2006 were \$8.1 million as compared to \$4.3 million in fiscal year 2005.

AlaskAdvantage<sup>®</sup> Financing:

To facilitate financing the program for the 2006-2007 academic year, the Corporation issued \$85 million of tax-exempt, limited obligation, education loan revenue bonds under the 2002 Master Trust Indenture in May 2006.

AlaskAdvantage<sup>®</sup> Borrower Benefits:

Under the AlaskAdvantage<sup>®</sup> Program the Corporation's Board of Directors has approved various loan benefit features that provide incentives and rewards to borrowers who participate in the program.

Under the AlaskAdvantage<sup>®</sup> Borrower Benefit Program, effective July 1, 2006 through June 30, 2007, borrowers with qualified loans held by the Corporation will be eligible for certain interest rate reductions or rebates on any such loan.

Borrower Benefit Program offerings are subject to the availability of funds and annual modifications or termination by the Corporation at its discretion provided, however, that

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

any changes do not adversely effect the credit rating of certain bonds issued by the Corporation.

**Contacting the Corporation's Financial Management**

This financial report is designed to provide our customers, investors, and creditors with a general overview of the Corporation's finances and to demonstrate the Corporation's accountability for its assets. If you have any questions about this report or need additional financial information, contact the Finance Officer of the Corporation at (907) 465-6757.

# ELGEE REHFELD MERTZ, LLC

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## INDEPENDENT AUDITORS' REPORT

The Board of Directors  
Alaska Student Loan Corporation  
Juneau, Alaska

We have audited the accompanying basic financial statements of the Alaska Student Loan Corporation (Corporation), a component unit of the State of Alaska, as of and for the years ended June 30, 2006, and 2005, on pages 8 to 34. These financial statements are the responsibility of the management of the Corporation. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects the financial position of the Alaska Student Loan Corporation as of June 30, 2006, and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 11, 2006, on our consideration of the Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 1 through 6, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



September 11, 2006



# ALASKA STUDENT LOAN CORPORATION

(a Component Unit of the State of Alaska)

## Balance Sheets

June 30, 2006 and 2005

Assets	2006	2005
Current assets:		
Investments (note 3)	\$ 51,775,775	41,939,549
Accrued interest receivable	134,937	154,696
Total current assets	51,910,712	42,094,245
Restricted assets:		
Cash (note 3)	803,103	1,486,711
Investments (note 3)	436,676,594	402,159,490
Loans receivable (note 4)	614,003,621	591,116,455
Less allowance for:		
Doubtful loans (note 5)	(107,283,104)	(103,356,058)
Forgiveness (note 6)	(2,348,036)	(2,644,986)
Net loans receivable	504,372,481	485,115,411
Accrued interest receivable, net of forgiveness allowance of \$401,747 and \$725,122 in 2006 and 2005, respectively	18,544,348	17,380,522
Due from U.S. Department of Education	856,820	1,144,631
Bond issuance cost, net of accumulated amortization of \$3,344,369 and \$3,886,007 in 2006 and 2005, respectively	6,390,757	6,113,490
Total restricted assets	967,644,103	913,400,255
Total assets	\$ 1,019,554,815	955,494,500

(Continued)

See accompanying notes to the financial statements

# ALASKA STUDENT LOAN CORPORATION

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## Balance Sheets

June 30, 2006 and 2005

Liabilities and Net Assets	2006	2005
Liabilities:		
Current liabilities payable from unrestricted assets:		
Accounts payable	\$ 4,454,573	361,735
Due to State of Alaska	475,124	420,637
Warrants outstanding	42,616	8,527
Deferred credit (note 2)	3,525,342	4,949,598
Return of capital payment declared (note 11)	1,900,000	3,100,000
Total current unrestricted liabilities	<u>10,397,655</u>	<u>8,840,497</u>
Current liabilities payable from restricted assets:		
Accounts payable	13,735	5,047
Warrants outstanding (note 4)	402,858	423,056
Return of capital payment declared (note 11)	99,810,257	134,299,263
Bond interest payable	10,517,590	10,072,794
Current portion of arbitrage rebate payable (note 8)	84,663	182,793
Current portion of bonds payable (note 7)	58,150,000	53,475,000
Total current liabilities	<u>168,979,103</u>	<u>198,457,953</u>
Noncurrent liabilities payable from restricted assets:		
Arbitrage rebate payable (note 8)	695,076	385,025
Bonds payable, net of bond premiums/discounts (note 7)	668,437,403	578,943,155
Pension obligation payable (note 10)	641,175	-
Total noncurrent liabilities	<u>669,773,654</u>	<u>579,328,180</u>
Total liabilities	<u>849,150,412</u>	<u>786,626,630</u>
Commitments and contingencies (note 11)	-	-
Net assets:		
Restricted net assets	128,891,346	135,614,122
Unrestricted net assets (note 2)	41,513,057	33,253,748
Total net assets	<u>170,404,403</u>	<u>168,867,870</u>
Total liabilities and net assets	<u>\$ 1,019,554,815</u>	<u>955,494,500</u>

See accompanying notes to the financial statements

# ALASKA STUDENT LOAN CORPORATION

(a Component Unit of the State of Alaska)

Statements of Revenue, Expenses

and Changes in Net Assets

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenue - interest income - student loans	\$ <u>36,310,862</u>	<u>33,996,765</u>
Operating expenses:		
Provision for:		
Loan losses (note 5)	5,038,071	5,048,581
Forgiveness (note 6)	306,268	736,098
Operations	<u>12,448,379</u>	<u>10,303,231</u>
Total operating expenses	<u>17,792,718</u>	<u>16,087,910</u>
Operating income	<u>18,518,144</u>	<u>17,908,855</u>
Nonoperating revenue (expense), excluding special item:		
Interest income from investments	13,035,070	11,196,953
Interest expense	(27,547,506)	(22,827,011)
Arbitrage rebate	(394,715)	54,994
Amortization of bond issuance costs	(926,587)	(841,613)
Change in estimate of forgiveness allowances (note 2)	<u>752,127</u>	<u>-</u>
Net nonoperating expense	<u>(15,081,611)</u>	<u>(12,416,677)</u>
Income before return of capital ("statutory net income")	3,436,533	5,492,178
Return of capital (note 11)	<u>(1,900,000)</u>	<u>(88,100,000)</u>
Change in net assets	<u>1,536,533</u>	<u>(82,607,822)</u>
Total net assets-beginning	<u>168,867,870</u>	<u>251,475,692</u>
Total net assets-ending	\$ <u><u>170,404,403</u></u>	<u><u>168,867,870</u></u>

See accompanying notes to the financial statements

# ALASKA STUDENT LOAN CORPORATION

(a Component Unit of the State of Alaska)

## Statements of Cash Flows

Years ended June 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Principal repayments received on loans	\$ 51,724,434	49,798,647
Interest received on loans	27,769,515	25,081,710
Other cash receipts	1,259,840	1,495,261
Loans originated	(70,732,628)	(64,668,614)
Cash paid to Alaska Commission on Postsecondary Education for operating expenses	(11,888,446)	(9,980,250)
Net cash provided by (used for) operating activities	(1,867,285)	1,726,754
Cash flows from noncapital financing activities:		
Proceeds from issuance of bonds	148,985,768	-
Bond issue costs	(1,202,451)	(50,342)
Interest paid on bonds	(22,718,754)	(20,954,333)
Principal payments on bonds	(41,400,000)	(81,495,000)
Net cash provided by (used for) noncapital financing activities	83,664,563	(102,499,675)
Cash flows from investing activities:		
Interest received on investments	14,031,430	10,618,695
Investments matured	6,606,641,944	6,920,039,252
Investments purchased	(6,647,763,375)	(6,886,109,480)
Net cash provided by (used for) investing activities	(27,090,001)	44,548,467
Cash flows from capital activities:		
Proceeds from issuance of bonds	-	94,254,660
Bond issue costs	(1,403)	(1,038,314)
Interest paid on bonds	(5,725,476)	(1,957,406)
Principal payments on bonds	(12,075,000)	(5,965,000)
Return of capital payments	(37,589,006)	(31,300,737)
Net cash provided by (used for) capital activities	(55,390,885)	53,993,203
Net decrease in cash	(683,608)	(2,231,251)
Cash (all restricted) at beginning of period	1,486,711	3,717,962
Cash (all restricted) at end of period	\$ 803,103	1,486,711

(Continued)

See accompanying notes to the financial statements

# ALASKA STUDENT LOAN CORPORATION

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## Statements of Cash Flows

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Reconciliation of operating income to net cash provided by (used for) operating activities:		
Operating income	\$ 18,518,144	17,908,855
Adjustments to reconcile operating income to net cash provided by (used for) operating activities:		
Increase in net loans receivable	(18,903,718)	(9,596,214)
Increase in net accrued interest receivable on loans	(1,068,143)	(140,286)
Decrease (increase) in other assets	287,811	(754,365)
Increase in accounts payable	13,324	176,419
Increase (decrease) in due to State of Alaska	54,487	(68,004)
Increase (decrease) in warrants outstanding	13,891	(155,683)
Decrease in deferred credit	(1,424,256)	(5,643,968)
Increase in pension obligation	641,175	-
	<u>(20,385,429)</u>	<u>(16,182,101)</u>
Net cash provided by (used for) operating activities	\$ <u>(1,867,285)</u>	<u>1,726,754</u>
Summary of noncash transactions that affect recognized assets and liabilities:		
Provision for loan loss and forgiveness	\$ (5,344,339)	(5,784,679)
Provision for lost interest and forgiveness	(5,651,791)	(3,576,425)
Write-off of uncollectible loans	3,925,538	7,537,473
Forgiveness granted - principal	(249,866)	(487,167)
Forgiveness granted - interest	(57,424)	(115,947)
Bond premium (discount) amortization	1,341,520	415,126
Bond issuance cost amortization	(926,587)	(841,613)
Deferred credit used for loan loss	2,814,513	6,511,939
Deferred credit amortization	-	418,705
Interest capitalization	8,333,234	8,073,000
Unrealized loss on investments	(856,303)	(901,646)
Change in forgiveness estimates	752,127	-
Pension obligations	(641,175)	-

See accompanying notes to the financial statements

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Notes to Financial Statements

June 30, 2006 and 2005

(1) **Authorizing Legislation and Organization**

The Alaska Student Loan Corporation (Corporation), a component unit of the State of Alaska, was created in 1987 by an act of the State of Alaska Legislature (Legislature). The purpose of the Corporation is to provide low-interest education loans to Alaskans. The Corporation is authorized, with certain limitations, to issue its own bonds and other obligations in such principal amounts as, in the opinion of the Corporation, will be necessary to provide sufficient funds for carrying out its purpose. All obligations so issued shall not be deemed to constitute a debt of the State of Alaska (State).

The State Governor appoints the Corporation's Board of Directors and the staff of the Alaska Commission on Postsecondary Education (Commission) administers the Corporation. The Commission's budget provides for reimbursement from the Corporation for operating and capital expenses. The Commission's budget is subject to review and approval from both the executive and legislative branches of the State.

The State has provided education loans through various programs since 1968. Prior to the creation of the Corporation, substantially all such loans were recorded in the Scholarship Revolving Loan Fund and Teacher Scholarship Loan Fund (Funds) of the State. In April 1988, by act of the Legislature, the assets, liabilities, and equities of the Funds were transferred to the Corporation effective December 30, 1987.

Loans are financed through the issuance of tax-exempt bonds or with recycled principal and interest repayments. The bonds outstanding are payable primarily from interest and principal repayments on the financed loans as specified in the underlying resolutions authorizing the sale of bonds.

(2) **Summary of Significant Accounting Policies**

(a) ***Fund Accounting***

The financial activities of the Corporation, which are restricted by the Corporation's bond indentures and the requirements of the Legislature, are recorded in various funds as specified in such instruments or necessitated by appropriation requirements or sound fiscal management. The funds are combined for financial statement purposes and there are no significant interfund transactions. The Corporation's funds are considered to be enterprise funds for financial reporting purposes with revenues recognized when earned and expenses when incurred.

(b) ***Standard Application***

As allowed by the Government Accounting Standards Board Statement No. 20 (GASB 20), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Corporation has elected not to apply Statements and Interpretations issued by the Financial Accounting Standards Board after November 30, 1989.

(c) ***Fiscal Year***

The Corporation's fiscal year begins July 1 and ends June 30, consistent with the State's fiscal year.

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Notes to Financial Statements

June 30, 2006 and 2005

(d) ***Management Estimates***

In preparing the financial statements in accordance with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses. Actual amounts could differ from those estimates. The more significant accounting and reporting policies applied in the preparation of the accompanying financial statements are discussed below.

(e) ***Loans***

Loans represent education loans issued through the AlaskAdvantage<sup>®</sup> Loan Programs, which include Alaska Supplemental Loans, Teacher Education Loans (TEL), Family Education Loans (FEL), (collectively referred to as supplemental loans), and federally guaranteed Stafford, PLUS and Consolidated loans. The terms of the loans vary depending on the year of inception and loan type. Interest accrues at fixed and variable rates ranging from 2.875% to 9% and is generally determined by loan type and issue date. The Corporation offers borrower benefits, which reduce the interest costs for eligible borrowers. The borrower benefit offerings are approved by the Corporation Board of Directors annually and may vary from year-to-year.

A borrower of TEL can obtain up to 100% forgiveness of loan principal and interest if the borrower teaches in rural Alaska for periods specified by the program.

(f) ***Allowance for Doubtful Loans***

The allowance for doubtful loans represents management's estimate, based on experience, of all loans that will ultimately be uncollectible. The Corporation charges off supplemental loans to the allowance upon death, bankruptcy as allowed by law, total disability of the borrower, or when a payment has not been received for five years on loans not in deferment.

(g) ***Interest on Education Loans***

Interest on education loans is accrued when earned. For federally guaranteed subsidized loans, interest from the disbursement date of the loan until a date that is six months after the student withdraws from school (plus any authorized deferment periods) is billed to and paid by the U.S. Department of Education under the Federal Family Education Loan Program. The borrower pays interest subsequent to that date. For non-subsidized federally guaranteed loans and for all supplemental loans issued after June 30, 2002 interest from the disbursement date is paid by the borrower.

Certain supplemental loans are non-interest bearing while the borrower is completing eligible studies. All state supplemental loans issued prior to July 1, 1996 are non-interest bearing during approved periods of deferment and postponement. Loans issued prior to July 1, 1987 are also non-interest bearing during a one-year grace period following completion of studies and a six-month sub-grace period following an approved deferment. Non-interest bearing loans are approximately \$11,517,409 and \$22,774,663 at June 30, 2006 and 2005, respectively.

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Notes to Financial Statements

June 30, 2006 and 2005

Historical rates are used to determine the allowance for doubtful interest. The allowance for doubtful interest is approximately \$23,300,000 and \$20,500,000 as of June 30, 2006 and 2005, respectively. The provision for doubtful interest is a reduction of interest income and was approximately \$5,520,000 and \$3,444,000 for the years ended June 30, 2006 and 2005, respectively.

(h) ***Deferred Credit***

Borrowers who received supplemental loans after June 30, 1994 were charged an origination fee of 1%, 3% or 5%, generally determined by loan issue date. Its purpose is to offset loan losses due to death, disability, bankruptcy or default of borrowers charged the origination fee. The origination fee is recognized as revenue using the straight-line method equal to the loan repayment period and assumes repayment begins the year following origination. The allowance for doubtful loans has been reduced by the unamortized deferred credit.

(i) ***Allowance for Forgiveness***

The allowance for forgiveness represents management's estimate, based on experience of the loan forgiveness that will ultimately be applied for and granted. In fiscal year 2006, management changed the allowance estimate to reflect expected forgiveness for the Teacher Education loan program only. To determine this change, management analyzed recent annual forgiveness activity for certain supplemental loans awarded prior to July 1, 1987 in conjunction with eligibility requirements and concluded that the allowance for those loans was no longer necessary.

(j) ***Bond Issuance Costs***

Bond issuance costs include underwriters' fees and other costs incurred in connection with the issuance of bonds and are amortized using the straight-line method.

(k) ***Bond Discounts/Premiums and Deferred Amounts on Refundings***

Bond discounts, premiums and deferred amounts on refundings are amortized using the straight-line method.

(l) ***Income Taxes***

The Corporation, as a government instrumentality, is exempt from federal and state income taxes.

(m) ***Investments***

The Corporation carries all investments at fair value.

(n) ***Unrestricted Net Assets***

Unrestricted net assets represent assets of the Corporation not pledged as collateral for specific bond indentures. GASB Statement No. 34 requires assets restricted by statute to be reported as unrestricted. Assets restricted by statute are approximately \$22,800,000 and \$31,200,000 at June 30, 2006 and 2005, respectively.



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(3) **Cash and Investments**

(a) ***Cash***

Cash, consisting mainly of deposits held in trust, is \$803,103 and \$1,486,711 at June 30, 2006 and June 30, 2005 respectively. Cash is restricted by bond resolutions.

(b) ***Investments***

The fair value as of June 30, of the Corporation's investments, a majority of which are restricted by bond resolutions and statutory agreements, is shown below:

		2006	2005
Restricted	\$	436,676,594	402,159,490
Unrestricted		51,775,775	41,939,549
	\$	<u>488,452,369</u>	<u>444,099,039</u>

Restricted investments include amounts specifically designated for financing education loans totaling \$112,638,609 and \$42,086,687 at June 30, 2006 and 2005, respectively.

The Corporation invests in the State's General Fund and Other Non Segregated Investments Pool (GeFONSI).

		2006	2005
Non-pooled	\$	462,743,018	428,080,323
Pooled		25,709,351	16,018,716
	\$	<u>488,452,369</u>	<u>444,099,039</u>

The fair value of debt security investments as of June 30 is shown below, including contractual maturities at June 30, 2006. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

		Investment Maturities (in Years)			Totals	
		Less than 6	6-10	More than 10	2006	2005
Interest earning						
investment contracts <sup>1</sup>	\$	90,722,000	22,036,300	11,514,000	124,272,300	52,433,500
U.S. Treasury securities		47,211,705	690,182	1,128,868	49,030,755	43,864,681
U.S. Government						
agencies securities		113,943,990	1,237,651	7,300,860	122,482,501	224,493,411
Corporate bonds		1,543,782	1,082,720	426,740	3,053,242	4,058,984
Asset-backed securities		1,956,134	585,087	785,821	3,327,042	7,407,634
Money market funds		160,577,178	-	-	160,577,178	95,822,113
Total non-pooled investments	\$	<u>415,954,789</u>	<u>25,631,940</u>	<u>21,156,289</u>	<u>462,743,018</u>	<u>428,080,323</u>

<sup>1</sup> This includes repurchase agreements and investment contracts with third-parties.

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(c) ***Investment Policies***

The Corporation utilizes different investment strategies depending upon the nature and intended use of the assets being invested. All funds are classified as pledged or non-pledged and are managed either by staff or by external investment managers. All of these factors determine the applicable investment guidelines used when making investment decisions. The Corporation's investment policies provide investment guidelines for non-pledged funds.

The following securities are eligible for investment under the Corporation's investment policies:

- Debt instruments issued by the U.S. Government, its Agencies and Instrumentalities.
- Investment contracts and repurchase agreements with a corporation or other entity which has a long-term debt rating of at least A3 by Standard and Poor's (S&P) or A- by Moody's and where collateral is maintained at a minimum level of 102% when using direct obligations of the U.S. Treasury or 103% when using allowable agency securities.
- Guaranteed investment contracts with a corporation or other entity which has a long-term debt rating of at least A3 by Standard and Poor's (S&P) or A- by Moody's. The contract maturity is limited to five years or less.
- Investments in a money fund rated AAAM or AAAM-G or better by Standard & Poor's and Aaa by Moody's.

In addition to the above guidelines, the following apply to non-pledged funds managed by an external investment manager:

- General obligations of any state or municipality with a published rating of low "A" or better, and debt instruments that have been issued by domestic entities rated low "A" category or above by at least two of the following rating services: S&P, Moody's, Fitch ratings or the equivalent by another nationally recognized rating agency, and dollar denominated debt instruments of comparable quality issued by non-domestic entities.
- Government National Mortgage Association, the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation mortgage backed instruments as well as asset-backed securities.
- Certificates of deposit and term deposits of United States Domestic financial institutions which are members of the Federal Deposit Insurance Corporation provided that such entities have the highest credit rating assigned by a nationally recognized rating service, and which may be readily sold in the secondary market at prices reflecting fair value.
- Short-term domestic corporate promissory notes (commercial paper) payable in United States dollars of the highest rating assigned by a nationally recognized rating service.

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(d) ***Concentration Risk***

Concentration risk is the risk of loss attributed to the magnitude of the Corporation's investment in a single issuer. Concentration limits are not established in the bond indentures and governing agreements for pledged investments. The Corporation's policies set out maximum concentration limits for all investment contracts and for non-pledged funds managed by an external investment manager.

For investment contracts, the diversification standard is two-fold and applies to each bond indenture individually. First, investment agreement providers will be limited to providing investments to the lesser of \$50,000,000 or 25% of total financial assets. Second, no investment agreement provider may hold more than 25% of the total capital reserve fund investments. These diversification standards are not applicable to direct purchase investments or to acquisition funds that will be reduced to a maximum of \$50,000,000 in the first six months of the agreement.

Concentration to any one issuer, of non-pledged funds managed by an external investment manager, other than securities of the U.S. Government, its agencies or instrumentalities, is limited to 5% of the portfolio's market value at the time of purchase.

Pledged funds are invested according to the terms outlined in their respective indentures or governing agreements, which generally mandate the purchase of relatively short-term, high quality fixed income securities. In those instances, if any, where an indenture or governing agreement is less restrictive than the Corporation's investment policies for non-pledged funds, the investment will be made in accordance with the more restrictive investment policy.

(e) ***Credit Risk***

Credit risk is the risk of loss due to the failure of the security or backer. The Corporation mitigates its credit risk by limiting investments to those permitted in the investment policies, diversifying the investment portfolio, and pre-qualifying firms with which the Corporation administers its investment activities. Additionally, for funds managed by external investment managers, the weighted average quality rating of the portfolio must be maintained at AA- or better as determined by Standard and Poor's or the equivalent by another nationally recognized rating agency.

The credit quality ratings of the Corporation's investments as of June 30 as described by nationally recognized statistical rating organizations, are shown below. U.S. Treasury securities and securities of agencies and corporations that are explicitly guaranteed by the U.S. government in the amount of \$49,030,755 and \$43,864,681 at June 30, 2006 and 2005, respectively, are not considered to have credit risk and therefore, are not included in the summary.

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		Investment Fair Value	
Moody's	S&P	2006	2005
Securities of U.S. Government agencies and corporations:			
Aaa	AAA	\$ 58,765,174	226,622,541
Aa1	AA+	57,337	-
Aa1	AA-	-	159,916
Aa2	AA+	-	147,138
Aa2	AA	503,976	98,819
Aa2	A+	-	127,167
Aa3	AA-	1,347,196	-
Aa3	A+	-	306,978
Aa3	A	-	91,894
A1	A+	426,120	-
A1	A	-	521,464
A2	A	289,871	476,478
		61,389,674	228,552,395
Money market funds:			
Aaa	AAA	159,788,272	95,061,369
Unrated investments:			
Investment contracts		124,272,300	52,433,500
US Government agencies		64,146,069	-
Asset-backed securities		3,327,042	7,407,634
Money market funds		788,906	760,744
		192,534,317	60,601,878
		\$ 413,712,263	384,215,642

### (f) *Custodial Credit Risk*

The Corporation assumes levels of custodial credit risk for its deposits with financial institutions, bank investment agreements, and investments. For deposits, custodial credit risk is the risk that, in the event of a bank failure, the Corporation's deposits may not be returned. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Corporation will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The Corporation has not established a formal custodial credit risk policy for its investments.

As of June 30, 2006 the Corporation's bank balance of \$728,116 is fully covered by depository insurance. The Corporation had no investments registered in the name of a counterparty.

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(g) ***Interest Rate Risk***

Interest rate risk is the risk that the market value of investments will decline as a result of changes in general interest rates. For non-pledged investments, the Corporation mitigates interest rate risk by structuring its investment's maturities to meet cash requirements, thereby avoiding the need to sell securities in the open market prior to maturity. For investments held in trust, investment maturities are structured to meet cash requirements as outlined in its bond indentures and contractual and statutory agreements.

(h) ***Modified Duration***

Modified duration estimates the sensitivity of an investment to interest rate changes. The following table shows the Corporation's pledged and non-pledged investments with their weighted average modified duration as of June 30, 2006 by investment type:

	Investment Fair Value	Modified Duration
Investment contracts	\$ 124,272,300	3.22
U.S. Treasury securities	49,030,755	2.47
U.S. Government agencies securities	122,482,501	1.75
Asset-backed securities	3,327,042	6.60
Corporate bonds	3,053,242	5.25
Money market funds	160,577,178	-
	<u>\$ 462,743,018</u>	
Portfolio modified duration		1.67

The Corporation's investment policies require that the duration of each externally managed fixed income portfolio be within plus or minus 20% of the duration of the Lehman Aggregate Bond Index.

(i) ***Investment Holdings Greater than Five Percent of Total Non-pooled Portfolio***

The following investment holdings, summarized by issuer, include both investments that are governed by the maximum concentration limits of the Corporation's fiscal policy and investments which have no established concentration limits. Investments in mutual funds and investment pools are excluded from this summary. As of June 30, 2006 the Corporation has investment balances greater than five percent of the Corporation's total non-pooled investments with the following issuers:

Rabobank Guaranteed Investment Contract	\$	82,500,000	17.83%
FHLMC – Freddie Mac		52,905,967	11.43%
FNMA – Fannie Mae		49,694,370	10.74%
U.S. Treasury		49,030,755	10.60%

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(j) ***Pooled Investments***

The State's GeFONSI consists of investments in the State's Short-term and Intermediate-term Fixed Income Pools. Actual investing is performed by investment officers in the State's Department of Revenue, Treasury Division. A complete description of the investment policy for each pool is included in the Department of Revenue, Treasury Division, Policies and Procedures.

At June 30 the Corporation's share of pool investments, reported at fair value, is as follows:

Investment Type	Short-term Fixed Income Pool	Intermediate- term Fixed Income Pool	Securities Lending Collateral	Totals	
				2006	2005
Overnight sweep account	\$ 15,813	-	-	15,813	12,018
Money market	-	-	4,088,202	4,088,202	131,164
Short-term Investment Fund	389,403	-	-	389,403	-
Commercial Paper	781,000	-	-	781,000	689,544
U.S. Treasury bills	-	-	-	-	522,946
U.S. Treasury notes	-	6,332,500	-	6,332,500	3,803,312
U.S. Treasury slips	-	-	-	-	70,099
U.S. Government agency discount notes	-	-	-	-	589,027
U.S. Government agency	-	2,355,822	-	2,355,822	909,851
Mortgage-backed	672,313	1,397,058	-	2,069,371	2,746,453
Other asset-backed	4,675,031	314,947	-	4,989,978	4,060,064
Corporate bonds	2,418,791	2,071,089	-	4,489,880	2,760,342
Yankees: Corporate	99,269	68,907	-	168,176	67,073
Total Invested Assets	9,051,620	12,540,323	4,088,202	25,680,145	16,361,893
Pool related net assets (liabilities)	63,559	(34,353)	-	29,206	(343,177)
Net Invested Assets	\$ 9,115,179	12,505,970	4,088,202	25,709,351	16,018,716

**Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

**Short-term Fixed Income Pool:**

As a means of limiting its exposure to fair value losses arising from increasing interest rates, Treasury's investment policy limits individual fixed rate securities to fourteen months in maturity or fourteen months expected average life. Floating rate securities are limited to three years in maturity or three years expected average life. Treasury utilizes the actual maturity date for commercial paper and twelve month prepay speeds for other securities. At June 30, 2006 the expected average life of individual fixed rate securities range from one day to ten months and the expected average life of floating rate securities range from less than one year to three years.

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### Intermediate-term Fixed Income Pool:

Through its investment policy, Treasury manages its exposure to fair value losses arising from increasing interest rates by limiting the effective duration of its Intermediate-term Fixed Income Pool to  $\pm 20\%$  of the Merrill Lynch 1-5 year Government Bond Index. The effective duration for the Merrill Lynch 1-5 year Government Bond Index at June 30, 2006 was 2.28 years.

At June 30, 2006 the effective duration by investment type is as follows:

U.S. Treasury notes	2.01
U.S. Government agency	2.36
Mortgage-backed	2.79
Other asset-backed	1.06
Corporate bonds	2.65
Yankees-corporate	4.17
Pool effective duration	2.16

### Credit Risk

Credit risk is the risk that an issuer or other counter party to an investment will not fulfill its obligations.

Treasury's investment policy has the following limitations with regard to credit risk:

With the exception of the sweep account, Short-term Fixed Income Pool investments are limited to instruments with a long-term credit rating of at least A3 or equivalent and instruments with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's, Moody's and Fitch is A3 or equivalent. Asset-backed and non-agency mortgage securities may only be purchased if rated by one of the rating agencies mentioned above if they are rated AAA. Unexpected daily cash surpluses that arise in this pool are invested overnight in the custodian's repurchase agreement sweep account. Treasury does not have a policy to limit credit risk associated with the sweep account.

Intermediate-term Fixed Income Pool investments are limited to securities with a long-term credit rating of at least BBB3 or equivalent and securities with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's, Moody's and Fitch is BBB3 or equivalent. Asset-backed and non-agency mortgage securities may only be purchased if rated by one of the rating agencies mentioned above if they are rated AAA.

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At June 30, 2006 the State's Pools consisted of investments with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard and Poor's rating scale):

Investment Type	Rating <sup>1</sup>	Short-term Fixed Income Pool	Intermediate- term Fixed Income Pool
Overnight Sweep Account	Not Rated	0.17%	-
Short-term Investment Account	Not Rated	4.29%	-
Commercial paper	A-1	8.60%	-
U.S. Government agency	AAA	-	18.84%
Mortgage-backed	AAA	-	10.48%
Mortgage-backed	Not Rated	7.40%	0.69%
Other asset-backed	AAA	48.17%	1.67%
Other asset-backed	A	3.28%	0.85%
Corporate bonds	AAA	2.02%	5.78%
Corporate bonds	AA	15.32%	3.20%
Corporate bonds	A	9.27%	4.42%
Corporate bonds	BBB	-	3.17%
Yankees – corporate	AAA	-	0.24%
Yankees – corporate	AA	0.91%	-
Yankees – corporate	A	0.18%	0.13%
No credit exposure		0.39%	50.53%
		<u>100%</u>	<u>100%</u>

<sup>1</sup>Rating modifiers are not disclosed.

At June 30, 2006 the securities lending collateral is invested in a registered 2(a)-7 money market fund that is not rated.

Concentration of Credit Risk

Treasury's policy with regard to concentration of credit risk is to prohibit the purchase of more than five percent of a pool's holdings in corporate bonds of any one company or affiliated group. At June 30, 2006 the Corporation has more than five percent of its investments in Federal Home Loan Mortgage Corporation and Federal National Mortgage Association as follows:

	Fair Value	Percentage of Total Investments
Federal Home Loan Mortgage Corporation	\$ 1,755,897	7%
Federal National Mortgage Association	2,054,205	8%



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(k) ***Securities Lending***

Alaska Statute 37.10.071 authorizes the Commissioner of Revenue to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Commissioner entered into an agreement with State Street Corporation (the Bank) to lend securities in the Short-term and Intermediate-term Fixed Income Pools. The Bank, acting as the Commissioner's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

At June 30, 2006 and 2005 the fair value of securities on loan allocable to the Corporation totals \$4,013,029 and \$127,551, respectively.

There is no limit to the amount that can be loaned and the Commissioner is able to sell securities on loan. Loans are collateralized at not less than 102 percent of their fair value. Loaned securities and collateral is marked to market daily and collateral is received or delivered the following day to maintain collateral levels.

Cash collateral is invested in a registered 2(a)-7 money market fund. Maturities of investments in the money market fund generally do not match the maturities of the loaned securities because the lending agreements are terminable at will. Collateral securities may be pledged or sold upon borrower default. Since the Commissioner does not have the ability to pledge or sell the collateral securities unless the borrower defaults, they are not recorded in the financial statements. Securities under loan, cash collateral and cash collateral payable are recorded in the financial statements at fair value. The Bank, the Corporation and the borrower receive a fee from earnings on invested collateral. The Bank and the Corporation share a fee paid by the borrower for loans not collateralized with cash.

There is limited credit risk associated with the lending transactions since the Commissioner is indemnified by the Bank against any loss resulting from counterparty failure or default on a loaned security or its related income distributions. The Bank further indemnifies the Board against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the year ended June 30, 2006 there are no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions nor failures by any borrowers to return loaned securities.

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(4) **Restricted Loans Receivable**

A summary of restricted loans receivable, all of which are installment loans to individuals, at June 30 follows:

	2006	2005
Alaska Supplemental Loans	\$ 535,404,443	530,602,317
Teacher Education Loans	8,423,978	8,589,552
Family Education Loans	7,422,587	8,286,656
Federal Family Education Loans	62,752,613	43,637,930
	<u>\$ 614,003,621</u>	<u>591,116,455</u>

The loan portfolio summarized by loan status at June 30 follows:

	2006	2005
Enrollment	\$ 111,478,462	106,278,743
Grace	23,455,478	26,197,292
Repayment	427,266,679	394,206,964
Deferment	51,803,002	64,433,456
	<u>\$ 614,003,621</u>	<u>591,116,455</u>

Loans awarded and not disbursed at June 30, 2006 and 2005 total \$15,987,183 and \$13,624,374 respectively.

Included in loans receivable are \$375,898 and \$392,800 of loan warrants issued but not yet redeemed by the borrowers at June 30, 2006 and 2005, respectively. Redemption is contingent upon the borrowers meeting certain eligibility requirements.

Restricted loans receivables are pledged to the Corporation's outstanding bonds.

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**(5) Allowance for Doubtful Loans**

A summary of the activity in the allowance for doubtful loans at June 30 follows:

		2006	2005
		<u>                    </u>	<u>                    </u>
Balance at beginning of period	\$	103,356,058	99,333,011
Provision for loan losses		5,038,071	5,048,581
Net loans charged off		<u>(1,111,025)</u>	<u>(1,025,534)</u>
Balance at end of period	\$	<u><u>107,283,104</u></u>	<u><u>103,356,058</u></u>

**(6) Allowance for Forgiveness**

As described in note 2, the Corporation disburses loans of which principal and interest become eligible for forgiveness under certain conditions.

A summary of the activity in the allowance for forgiveness at June 30 follows:

		2006	2005
		<u>                    </u>	<u>                    </u>
Balance at beginning of period	\$	2,644,986	2,396,055
Provision for forgiveness		306,268	736,098
Forgiveness granted		(249,866)	(487,167)
Change in estimate (note 2(i))		<u>(353,352)</u>	<u>-</u>
Balance at end of period	\$	<u><u>2,348,036</u></u>	<u><u>2,644,986</u></u>

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(7) **Bonds Payable**

(a) Bonds payable at June 30 consist of the following:

	Original Amount	Amount outstanding	
		2006	2005
Outstanding under the 1988 Master Indenture:			
1995 Series A Student Loan Revenue Bonds serial bonds, fixed rates ranging	\$ 55,000,000	—	21,920,000
1996 Series A Student Loan Revenue Bonds serial bonds, fixed rates ranging from 5.85% to 6.35%, due 2007	38,000,000	26,000,000	28,500,000
1997 Series A Student Loan Revenue Bonds serial bonds, fixed rates ranging from 5.2% to 5.75%, due 2007 to 2015	75,000,000	60,000,000	69,000,000
1998 Series A Student Loan Revenue Bonds serial bonds, fixed rates ranging from 4.65% to 5.3%, due 2007 to 2016	88,570,000	49,000,000	50,000,000
1999 Series A Student Loan Revenue Bonds serial bonds, fixed rates ranging from 4.7% to 5.45%, due 2007 to 2017	40,000,000	32,500,000	34,750,000
2000 Series A Student Loan Revenue Bonds serial bonds, fixed rates ranging from 5.35% to 6.05%, due 2007 to 2018	32,140,000	30,540,000	31,645,000
term bonds, 6.0%, due July 1, 2016	7,860,000	7,860,000	7,860,000
2001 Series A Student Loan Revenue Bonds serial bonds, fixed rates ranging from 4.1% to 4.65%, due 2007 to 2011	33,345,000	20,650,000	24,275,000
Sub-total 1988 Master Indenture	\$ 369,915,000	226,550,000	267,950,000

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	Original Amount	Amount outstanding	
		2006	2005
Outstanding under the 2002 Master Indenture:			
2002 Series A and B Education Loan Revenue Bonds			
auction variable rate bonds, due 2011 to 2037	\$ 62,500,000	36,100,000	36,100,000
2003 Series A-1 and A-2 Education Loan Revenue Bonds			
auction variable rate bonds, due 2011 to 2038	47,000,000	47,000,000	47,000,000
2004 Series A-1, A-2, A-3 Education Loan Revenue Bonds			
auction variable rate bonds due 2044	93,100,000	93,100,000	93,100,000
serial bonds, fixed rates ranging			
from 5.0% to 5.25%, due 2011 to 2017	22,015,000	22,015,000	22,015,000
2005 Series A Education Loan Revenue Bonds			
serial bonds, fixed rates ranging			
from 4.0% to 5.0%, due 2008 to 2018	58,250,000	58,250,000	—
2006 Series A and B Education Loan Revenue Bonds			
auction variable rate bonds due 2040	30,000,000	30,000,000	—
serial bonds, fixed rate at 5%, due 2009 to 2018	55,000,000	55,000,000	—
	<u>\$ 367,865,000</u>	341,465,000	198,215,000
Plus bond premium		6,254,514	863,098
Sub-total 2002 Master Indenture		<u>\$ 347,719,514</u>	<u>199,078,098</u>
Outstanding under the 2004 Indenture:			
2004 Series A Capital Project Revenue Bonds			
serial bonds, fixed rates ranging			
from 2.0% to 4.0%, due 2007 to 2017	\$ 69,910,000	58,175,000	63,945,000
term bonds, 4.0%, due July 1, 2018	5,230,000	5,230,000	5,230,000
	<u>\$ 75,140,000</u>	63,405,000	69,175,000
Plus bond premium		1,987,523	2,152,999
Sub-total 2004 Indenture		<u>\$ 65,392,523</u>	<u>71,327,999</u>
Outstanding under the 2005 Indenture:			
2005 Series A State Projects Revenue Bonds			
serial bonds, fixed rates ranging			
from 5% to 5.5%, due 2007 to 2015	\$ 88,305,000	82,000,000	88,305,000
Plus bond premium		4,925,366	5,757,058
Sub-total 2005 Indenture		<u>\$ 86,925,366</u>	<u>94,062,058</u>
Total Bonds Payable	<u>\$ 901,225,000</u>	713,420,000	623,645,000
Plus bond premium		13,167,403	8,773,155
		<u>\$ 726,587,403</u>	<u>632,418,155</u>

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- (b) The minimum payments and sinking fund installments for the five years subsequent to June 30, 2006 and thereafter are as follows:

Period ending June 30	Principal	Interest	Total
2007	\$ 58,150,000	32,335,474	90,485,474
2008	37,380,000	29,274,196	66,654,196
2009	41,995,000	27,612,943	69,607,943
2010	43,045,000	25,603,376	68,648,376
2011	66,095,000	22,994,287	89,089,287
2012-2016	250,285,000	74,384,551	324,669,551
2017-2021	42,570,000	33,669,952	76,239,952
2022-2044	173,900,000	119,797,018	293,697,018
	<u>\$ 713,420,000</u>	<u>365,671,797</u>	<u>1,079,091,797</u>

- (c) The 1988 and 2002 Master Indenture Bonds are private activity bonds. The 2004 and 2005 Indenture Bonds are not private activity bonds. All of the bonds pay interest semiannually. The bonds are secured by education loans and other assets of the Corporation and are not obligations of the State.

All of the bonds are subject to certain early redemption features, both mandatory and at the option of the Corporation. In addition, the bond indentures contain covenants relative to restrictions on additional indebtedness.

All of the bonds outstanding under the 1988 Master Indenture are insured by Ambac Assurance Corporation. The 2004 Capital Project Revenue Bonds outstanding are insured by MBIA Insurance Corporation. The 2005 State Projects Revenue Bonds outstanding are insured by Financial Security Assurance, Inc.

- (d) On July 1, 2006 the Corporation will call all outstanding Series 1996 A Bonds at par in the amount of \$23,000,000.

**(8) Arbitrage Rebate Payable**

In connection with the Corporation's tax-exempt bond issues, the Corporation is subject to rebatable arbitrage when bond proceeds are invested in investments and education loans. Interest income from investments and education loans is limited by the U.S. Treasury regulations. The amount accrued for arbitrage rebate liability at June 30, 2006 and 2005 represents the amount of arbitrage rebate due to the federal government for excess earnings on the bond proceeds.

**(9) Student Loan Interest and Special Allowance on Federally Guaranteed Loans**

The U.S. Department of Education makes quarterly interest subsidy payments on behalf of qualified borrowers until the borrower is required under provisions of the Higher Education Act to begin repayment.

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Repayment on Stafford education loans normally begins within six months after borrowers complete their course of study, leave school, or cease to carry at least one-half the normal full-time academic load as determined by the educational institution. Repayment of PLUS loans normally begins within sixty days from the date of loan disbursement unless a deferment of payments has been granted. In these cases, full repayment of principal and interest would resume at the expiration of the deferment. Interest accrues during this deferment period.

The U.S. Department of Education provides a special allowance payment to lenders participating in the Stafford, PLUS, and Consolidation loan programs. Special allowance is paid based on a rate that is established quarterly. For loans first disbursed after June 30, 1999 and financed with obligations issued after October 1, 1993, the rate is based on the average rate established in the auction of the three-month Financial Commercial Paper, plus a predetermined factor, less the interest rate on the loan. Loans made or purchased with funds obtained through the issuance of tax-exempt obligations issued before October 1, 1993 are eligible for one-half of the special allowance rate, subject to a minimum return of 9.5%. Loans originated or purchased with funds obtained through the issuance of tax-exempt obligations originally issued after October 1, 1993 are eligible for full special allowance and are not subject to a minimum return.

**(10) Retirement Plan**

Effective July 1, 1997, the Commission adopted the provisions of Government Accounting Standards Board Statement No. 27 (GASB 27), *Accounting for Pensions by State and Local Government Employers*. There was no impact on the financial statements as a result of GASB 27.

**(a) Plan Description**

The Commission and its employees participate in the State of Alaska Public Employees' Retirement System (PERS), as a combined defined benefit and defined contribution, agent multiple-employer public employee retirement system which was established and is administered by the State to provide pension, post-employment healthcare, and death and disability benefits to eligible employees. All full-time employees are required to participate in PERS. Benefit and contribution provisions are established by State law and may be amended only by the Legislature.

Employees hired after June 30, 2006 participate in the defined contribution plan. Employees are eligible at retirement to receive 25% of the employer contributions after 2 years of service, 50% after 3 years, 75% after 4 years and 100% after five years.

Employees hired prior to July 1, 2006 participate in the defined benefit plan. For employees hired prior to July 1, 1986, with five or more years of credited service, are entitled to annual pension benefits beginning at normal retirement age fifty-five or early retirement age fifty. For employees hired after June 30, 1986 but before July 1, 2006, the normal retirement age is sixty and the early retirement age is fifty-five. The normal annual pension benefit for the first ten years of service is equal to 2% per year of the member's highest three-year average yearly compensation, 2.25% per year for the second ten years of service, and 2.5% per year thereafter. All service earned prior to July 1, 1986 is calculated using the 2% multiplier. Employees with thirty or more years of credited service may retire at any age and receive a normal benefit.

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Major medical benefits are provided without cost to all retirees first hired before July 1, 1986. Members with five or more years of credited service first hired after June 30, 1986, but before July 1, 1996, may elect major medical benefits. Members first hired after June 30, 1996, but before July 1, 2006, must have at least ten years of credited service to be eligible to elect major medical benefits. Members hired after June 30, 2006 must have at least ten years of credited service, must retire directly from State service, and must be a Medicare eligible age to be eligible to elect major medical benefits.

Each fiscal year, PERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the State of Alaska, Department of Administration, Division of Retirement and Benefits, P.O. Box 110203, Juneau, Alaska 99811-0203 or by calling (907) 465-4460.

(b) ***Fund Policy and Annual Pension Cost***

Employees are required, by State statute, to contribute 6.75% of their gross wage to the plan. The funding policy for PERS provides for periodic employer contributions which, prior to fiscal year 2005 fully funded the annual pension cost. In fiscal year 2006, the Corporation recognized a net pension obligation (NPO) of \$641,175, which is the difference between the actuarially determined rate and the contributions actually paid for the last two fiscal years. Although the amounts previously paid were the required contribution amounts for participating in PERS, the contribution rates are based on a capped rate, an annual maximum increase of 5 percent per year. This caused the required rate to be less than the actuarial determined rate, resulting in an NPO. Covered payroll for the period ended June 30, 2006 is \$4,702,787 constituting substantially the Commission's entire payroll.



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The Commission's annual pension contributions paid for the current year and the related information is as follows:

Contribution rates:

Employee	6.75%
Employer	17.65%

Annual pension cost to date	\$ 1,471,773
Contributions made	\$ 830,598

Actuarial valuation date	June 30, 2004
Actuarial cost method	Projected unit credit
Amortization method	Level percentage of pay
Amortization period	25-year fixed
Asset valuation method	5-year smoothed market

Actuarial assumptions:

Inflation rate	3.50% per year
Investment return	8.25% per year, compounded annually, net of expenses

Projected salary increase:

Inflation	3.50%
Productivity and merit	2.00%

Health cost trend

Medical	9.00%
Prescription	13.00%

## (11) Commitments and Contingencies

### (a) Operations

The Commission included approximately \$11,200,000 in its budget for fiscal year 2007 as reimbursement from the Corporation for administrative and capital expenses incurred on the Corporation's behalf. Amounts paid by the Corporation will be subject to revision based upon actual expenses incurred by the Commission.

### (b) Payment to the State of Alaska

During fiscal year 2000 the Legislature passed a bill that allows the Corporation to pay the State a return of contributed capital or dividend annually based on net income. If the Corporation's Board of Directors elects to make such a payment, the amount may not be less than 10%, nor greater than 35%, of the Corporation's income before transfers when it equals or exceeds \$2,000,000 for the Base Fiscal Year. The Base Fiscal Year is defined as the fiscal year ending two years before the end of the fiscal year in which the payment is made.

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On September 27, 2005 the Corporation's Board of Directors approved a \$1,900,000 Return of Capital payment to the State which will be paid during the fiscal year 2007.

During fiscal year 2004 the Legislature passed a bill allowing the Corporation an additional means to pay the State a return of contributed capital. The Corporation has issued \$163,445,000 of capital project bonds, the proceeds of which are for use in various State capital projects.

(c) ***State Permanent Fund Dividend Seizure***

The Alaska Permanent Fund (Permanent Fund) is a fund held and managed by the State and was established in the Alaska State Constitution in 1976. The State deposits a percentage of oil and gas royalties into the Permanent Fund. By statute, the State pays a portion of the earnings of the Permanent Fund (PFD) annually to individuals who apply and meet certain residency requirements, provided that sufficient funds are available for payment. The annual PFD paid to each eligible resident for the years 2005 and 2004 was \$846 and \$920 respectively. There can be no assurance that payments will continue. PFD payments could be eliminated or reduced by an amendment to the Alaska Statutes. The Commission may seize a borrower's Permanent Fund Dividend (PFD) payment, if any, to satisfy the balance of a defaulted loan pursuant to Alaska Statutes 14.43.145 and 43.23.067. To do so, the Commission issues certified claim letters to all borrowers of defaulted loans applying for PFDs, notifying them of the Commission's claim. The Commission has seizure priority over all other executors except State child support enforcement and any court ordered restitution. There is no assurance that any particular borrower will apply or qualify for a PFD payment.

PFD seizures collected by the Commission were approximately \$3,100,000 and \$3,400,000 for the years ended June 30, 2006 and 2005, respectively.

The Legislature and the Governor have, from time to time, considered various alternative measures including reducing or restricting the size of the PFD. The Corporation cannot predict whether any such measure will be enacted or the impact any such measure would have on loan collections through PFD seizures.

(d) ***General***

The education loan program has traditionally been the subject of legislative action by the State. The laws governing the program have been amended from time to time and will continue to be the subject of legislative proposals calling for further amendment. The effect, if any, on the program cannot be determined.

The Corporation is subject to interest rate risk relating to its variable rate bonds and the loans funded with bond proceeds. The bonds are subject to an interest rate cap of 14% while the loans are subject to an interest rate cap of 8.25% to 9.5% depending on the loan type. The Corporation has various strategies available to manage the risk that the bond rate may rise above the loan rate cap.

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(12) **Subsequent Events**

On July 1, 2006 the Corporation will call all outstanding Series 1996 A Bonds at par in the amount of \$23,000,000.